IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

ROYAL INDEMNITY COMPANY	:	
	:	
v.	:	
	:	**CIVIL ACTION**
DELI BY FOODARAMA, INC., GLEN ROSENWALD, SPECIALTY INSURANCE AGENCY, INC., FIRST NATIONAL FINANCIAL SERVICES, INC., FIRST TRUST BANK, INC., LITO AND SONS CLEANERS, INC. AND HARLEYSVILLE MUTUAL INSURANCE COMPANY	:	**NO. 97-1267**

M E M O R A N D U M

WALDMAN, J. **March 31, 1999**

I. Introduction

Presently before the court are plaintiff's motion for partial summary judgment and defendant Specialty Insurance Agency's motion for summary judgment.

Plaintiff seeks a declaration that an insurance policy issued to defendant Deli by Foodarama (Deli) is void (count I). Plaintiff asserts claims for breach of contract (count II) and negligence (count III) against defendant Specialty Insurance Agency, Inc. (Specialty). Plaintiff asserts claims for breach of contract (count IV) and for negligence against defendant First National Financial Services, Inc. (First National) (count V mislabeled as count IV). In count VI, (mislabeled as count V), plaintiff asserts common-law fraud claims against Deli, Glen Rosenwald, Deli's president and secretary, and First National.

In count VII (mislabeled as count VI) plaintiff asserts a claim against these defendants under the Pennsylvania Insurance Fraud Act, 18 Pa. C.S.A. § 4117, et seq., and in count VIII (mislabeled as count VII) a claim under the New Jersey Insurance Fraud Prevention Act, N.J. State. Ann. 17:33 A-1, et seq.[1] Defendant Deli has asserted counterclaims for bad faith pursuant to 42 Pa. C.S.A. § 8371 and for common-law fraud, alleging that plaintiff knew or should have known of the misrepresentations when it chose to continue insuring Deli.

Plaintiff seeks summary judgment on its claim for a declaration that an insurance policy it issued to defendant Deli by Foodarama is void, on its breach of contract and indemnification claims against defendant Specialty, on its statutory insurance fraud claim against Deli, its president, Glen Rosenwald, and defendant First National, and on Deli's counterclaims for bad faith and common-law fraud. Defendant Specialty has moved for summary judgment on plaintiff's contract and indemnification claims.[2]

Defendant Deli has not responded to plaintiff's motion.

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[1] Plaintiff never again mentions the New Jersey law claim in any submission including its motion and brief. The policy in question was delivered in Pennsylvania.

[2] All of the parties rely on and assume the applicability of Pennsylvania law with regard to each claim presented. Accordingly, the court has addressed the claims in the context of Pennsylvania law.

I. Legal Standard

In considering a motion for summary judgment, a court determines whether "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247 (1986); Arnold Pontiac-GMC, Inc. v. General Motors Corp., 786 F.2d 564, 568 (3d Cir. 1986). Only facts that may affect the outcome of a case are "material." Anderson, 477 U.S. at 248. All reasonable inferences from the record must be drawn in favor of the non-movant. See id. at 256.

Although the movant has the initial burden of demonstrating the absence of genuine issues of material fact, the non-movant must then establish the existence of each element on which it bears the burden of proof. See J.F. Feeser, Inc. v. Serv-A-Portion, Inc., 909 F.2d 1524, 1531 (3d Cir. 1990) (citing Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986)), cert. denied, 499 U.S. 921 (1991). The non-moving party may not rest on his pleadings, but must come forward with evidence from which a reasonable factfinder could render a verdict in his favor. See Anderson, 479 U.S. at 248; Williams v. Borough of West Chester, 891 F.2d 458, 460 (3d Cir. 1989); Woods v. Bentsen, 889 F. Supp. 179, 184 (E.D. Pa. 1995).

Even when the nonmovant fails to respond, the court must evaluate the merits of the motion and determine whether the movant is entitled to judgment as a matter of law. Custer v. Pan American Life Insurance Co., 12 F.3d 410, 416 (4th Cir. 1993); Anchorage Assoc. v. Virgin Islands Bd. of Tax Review, 922 F.2d 168, 175 (3d Cir. 1990); Ganci v. Borough of Jenkintown, 1998 WL 175881, *2 (E.D. Pa. Apr. 14, 1998).

III. Facts

From the competent evidence of record the pertinent facts, as uncontested or otherwise noted and respectively construed in the light most favorable to each nonmovant, are as follow.

Plaintiff and defendant Specialty had a general agency agreement under which Specialty was to "produce, underwrite, bind and issue insurance policies" on behalf of plaintiff. Plaintiff's underwriting guidelines provided in pertinent part that "[r]isks demonstrating any of the following characteristics are not eligible for this program ... [e]stablishments that have exhibited signs of operational difficulties ... includ[ing] claim frequency, citations, revocation of license, law suits ... [e]stablishments that have sustained a loss in excess of $15,000 in the last five years." (emphasis in original). Plaintiff provided that an application for a policy "Must be Signed by Insured to Bind."

The general agency agreement contained an indemnification clause which provided that:

> AGENCY shall indemnify and hold harmless Royal . . . from and against any loss, cost, claim, expense, damage, liability, penalty, fine, punitive or exemplary damages, including fines imposed by any insurance department or regulatory body or expense (including reasonable outside attorney's fees) incurred, arising out of or in connection with or resulting directly or indirectly from the following:
>
> > a. A breach by Agency or any sub-producer of Agency of any term or condition of this agreement, and/or
> >
> > b. Any error, omission or negligent act performed by Agency, its agent's servants, employees and service companies utilized by the Agency.

Under the general agency agreement, Specialty was required to comply with plaintiff's underwriting guidelines.

Specialty submitted the testimony of its senior underwriter, James Drummond, that issuing and binding insurance policies in the absence of a signed application was common practice in the commercial insurance business, that plaintiff knew Specialty sometimes did so on its behalf and that it acquiesced in the practice. Specialty also produced evidence that plaintiff has paid a number of claims exceeding $25,000 in the past nine years on insurance policies issued pursuant to unsigned applications.

Specialty and defendant First National were parties to a brokerage agreement. That agreement contained an indemnification clause which provided, in pertinent part, that

> [n]otwithstanding any other provision of this Agreement and as a special consideration of the execution of this Agreement by Specialty, the Broker agrees . . . that it will hold Specialty, and Specialty agents . . . free and harmless, and indemnify them from each and every claim of alleged errors and omissions caused by or related to, the acts of the Broker, its agents, servants, principals and employees, including legal fees, costs and disbursements that may reasonably be incurred by Specialty in the defense of such claim or claims to the full extent thereof, with interest thereon, until paid.

On March 19, 1996, First National faxed to Specialty an insurance application for defendant Deli. Plaintiff issued an insurance policy to Deli, effective the same day. The application contained a number of false representations, including misstatements retarding Deli's history of litigation and insurance claims. The application was not signed by Glen Rosenwald, Deli's president and secretary, or by any other Deli employee.

Specialty canceled Deli's policy on May 7, 1996, after receiving a Dun and Bradstreet report showing a $50,000 judgment and four lawsuits pending against Deli and after Deli failed to respond to repeated inquiries regarding the report. Only after the cancellation, did Deli respond. Based on assurances of Mr.

Rosenwald and Nathan Kleeman, First National's president, that the judgment was satisfied and three of the lawsuits were settled, Specialty reinstated Deli's policy without a lapse in coverage on July 8, 1996.

Following reinstatement of the policy, Deli submitted claims to plaintiff for a theft loss on May 28, 1996 and a fire loss on July 11, 1996. At a subsequent examination under oath conducted by plaintiff, Mr. Rosenwald acknowledged at least seven prior insurance claims of Deli which were not disclosed on the application. It is uncontroverted on the record presented that had plaintiff or Specialty known the true facts, neither would have insured Deli or they would have canceled the policy upon discovering the truth.

At a deposition in this case, Mr. Rosenwald testified that he never saw the insurance application, had no idea who prepared it or where the information in it came from. He testified that he could not recall anyone asking him for information to questions of the type contained in the application. Mr. Grossman and Mr. Kleeman testified that Mr. Grossman filled in the application from information given to him by Mr. Rosenwald in a face to face meeting.

In response to a request for admissions by plaintiff, First National admitted it was an "agent" for Deli without further elaboration. Specialty states in its brief that First

National admitted it acted as Deli's agent "when it submitted the application." In this regard, it attaches a response stating "admitted" but does not submit the corresponding request (#3). Deli failed to respond to plaintiff's requests for admission including one that First National was "an agent for Deli," thus implicitly admitting to such.

IV. Discussion

A. Plaintiff's Motion for Summary Judgment

1. Plaintiff's Declaratory Judgment Claim

Under Pennsylvania law, an insurance policy is void ab initio for misrepresentation when the insurer can establish that the insured knowingly or in bad faith made a false representation which was material to the risk being insured. See Matinchek v. John Alden Life Ins. Co., 93 F.3d 96 (3d Cir. 1996); American Equity Ins. Co. v. DiDominic, 19 F. Supp.2d 395, 397 (E.D. Pa. 1998). An insured acts in bad faith when he makes a false statement while aware that he does not know whether or not his statement is true. See Evans v. Penn Mut. Life Ins. Co., 186 A. 133, 138 (Pa. 1936); Tudor Ins. Co. v. Twp. of Stowe, 697 A.2d 1010, 1016 (Pa. Super. 1997).

It is uncontested that the application contains false representations about Deli's prior litigation and claims history. A misrepresentation is material if the truth would have caused the insurer to refuse the risk or to demand a higher premium.

See New York Life Ins. Co. v. Johnson, 923 F.2d 279, 281 (3d Cir. 1991); Jung v. Nationwide Mut. Fire Ins. Co., 949 F. Supp. 353, 357 (E.D. Pa. 1997); Federated Life Ins. Co. v. Walker, 1997 WL 33264, at *12 (E.D. Pa. Jan. 21, 1997). In either case, the policy is void ab initio. Johnson, 923 F.2d at 282. A history of frequent claims or lawsuits are among the risk factors articulated in plaintiff's underwriting guidelines. Misrepresentations regarding prior claims are clearly material. See Metropolitan Property and Liability Ins. Co. v. Insurance Com'r. of Penna., 580 A.2d 300, 303 (Pa. 1990) (three undisclosed prior claims for losses totaling $17,000 were "certainly material").

An insurer whose agent knows the true facts and which then issues or continues coverage cannot later disclaim that coverage based on a misrepresentation of those facts. See Headley's Express and Storage Co. v. Pennsylvania Indem. Co., 178 A. 816, 818 (Pa. 1935); Selected Risks Ins. Co. v. Schwabenbauer, 540 F. Supp. 22, 24 (E.D. Pa. 1982) (where insurer's agent knew true facts, insurer could not disclaim coverage based on provision inconsistent with those facts). There is evidence that Specialty was aware of misrepresentations in the Deli application regarding prior litigation when it reinstated the policy. That Specialty knew about some undisclosed risks, however, does not show it would have reinstated coverage had it known of all of the

undisclosed risks. There is uncontroverted evidence that Deli filed at least seven insurance claims in the five years preceding its application to plaintiff.

If the misrepresentation regarding Deli's claims history was made by Mr. Rosenwald, plaintiff is entitled to rescind the policy. The result could be different, however, if the false information was generated by First National as plaintiff's agent or subagent, a question that cannot be conclusively resolved on the present record.

The distinction between broker and agent is "more useful in the insurance industry than in the law" and is not dispositive. See Kairys v. Aetna Casualty and Surety Co., 461 A.2d 269, 273 (Pa. Super. 1983). A broker may act in part as an agent for an insured in obtaining insurance while simultaneously acting as an agent or subagent of the insurer. Id. The caselaw generally holds that a broker who solicits business from persons who rely on him to select the insurer is deemed an agent of the insured. There are also cases which hold that a solicitor for a general agent is also a subagent of the insurer. See Richardson v. John F. Kennedy Memorial Hospital, 838 F. Supp. 979, 985 (E.D. Pa. 1993) (acts of subagent may bind principal); McGonigle v. Susquehanna Mut. Fire Ins. Co., 31 A. 868, 873 (Pa. 1895) (solicitor for general agent was subagent whose acts "have the same effect" as if done by general agent); Pennsylvania Company

for Insurance on Lives v. Home Ins. Co. of America, 145 A. 286, 289 (Pa. 1929) (solicitor of insurance business for insurer's general agent was subagent whose acts may bind insurer); Isaac v. Donegal & Covoy Mut. Fire Ins. Co., 162 A. 300, 301 (Pa. 1932) (solicitor for general agent was subagent whose knowledge may be imputed to insurer); Harris v. Sachse, 52 A.2d 375, 379 (Pa. Super. 1947) (acts of party to whom general agent has delegated authority are as binding on insurer as acts of agent). See also Restatement (Second) of Agency § 142, cmt. b (subagent has same power as agent to create contractual relations between principal and third parties).

Who bears responsibility for the misrepresentations and the precise relationship in fact and practice between First National and Specialty as general agent for plaintiff cannot be conclusively determined as a matter of law on the record presented.

Summary judgment will not be granted on plaintiff's claim for a declaratory judgment.

2. Plaintiff's Breach of Contract and Indemnification Claims Against Specialty

Under the general agency agreement, Specialty was required to comply with plaintiff's underwriting guidelines and to indemnify plaintiff for losses resulting from a failure to do so or from acts of agents utilized by Specialty.

Plaintiff contends that Specialty breached its contract with plaintiff by binding and issuing a policy to Deli although it had not signed the application, and by issuing and later reinstating the policy although Deli was an uninsurable risk under the underwriting guidelines.

The relevant underwriting guidelines provided that among the risks demonstrating ineligibility for coverage were claim frequency and losses in excess of $15,000 in the preceding five years. It is also uncontroverted that contrary to plaintiff's requirements, Specialty bound and issued the policy without the signature of a Deli officer or principal.

There is evidence, however, that issuing and binding insurance policies upon unsigned applications was common practice in the commercial insurance business, that plaintiff knew Specialty sometimes did so on its behalf and that it acquiesced in the practice. Specialty also produced evidence that plaintiff has paid a number of claims exceeding $25,000 in the past nine years on insurance policies issued pursuant to unsigned applications.

It is not contested that liability pursuant to a court judgment is considered a "loss" for purposes of assessing an insurance risk. Whether or not a judgment is considered a loss when it is entered or when it is satisfied, this would have occurred within the five years preceding Deli's application for insurance. There is no evidence of record that Deli satisfied this judgment by paying less than $15,000. It thus appears that Specialty reinstated Deli's policy knowing it had sustained a loss in excess of $15,000 within the preceding five years.

Whether claims or suits have been "frequent" or sufficient in number to reflect an unacceptable risk calls for the exercise of some judgment and discretion. Whether or not an applicant has experienced a loss exceeding $15,000 in the previous five years, however, is a rather clear cut question. Nevertheless, it is not altogether clear plaintiff forbade Specialty to issue and bind a policy for any applicant with even a single loss exceeding $15,000 within five years regardless of the circumstances, or whether the risk factors in the guidelines were to be considered in the aggregate and could be applied flexibly depending on the particular circumstances. It is uncontroverted that Specialty would not have issued or reinstated the Deli policy had it known of the seven or more undisclosed prior claims.

If Mr. Rosenwald is believed and it appears that Mr. Grossman was responsible for the pertinent misrepresentations, plaintiff could be entitled to indemnification.

The court will not grant summary judgment on these claims on the record presented.

3. Plaintiff's Insurance Fraud Claim

The Pennsylvania Insurance Fraud Act provides, inter alia, that a person "may not knowingly and with intent to defraud any insurance company, self-insured, or other person file an application for insurance containing any false information, or conceal for the purposes of misleading information concerning any fact material thereto." See 18 Pa. C.S.A. § 4117(b)(4). An insurer damaged by insurance fraud may recover compensatory damages, including reasonable investigative expenses, costs of suit and attorney fees. See 18 Pa. C.S.A. § 4117(g). An insurer may recover treble damages from a defendant who has engaged in a pattern of conduct violating the Act. Id.

From the evidence of record a reasonable factfinder would not be compelled to conclude that Deli or First National engaged in a "pattern of conduct" violating the Act. The act is aimed at serial offenders. Several misrepresentations regarding the same subject matter or made in connection with a single transaction or claim generally do not constitute a "pattern" within the meaning of § 4117. See Parasco v. Pacific Indemn.

Co., 920 F. Supp. 647, 657 (E.D. Pa. 1996); Ferrino v. Pacific Indemnity Co., 1996 WL 32146, *4 (E.D. Pa. Jan. 24, 1996); Peer v. Minnesota Mut. Fire & Casualty Co., 1995 WL 141899, *13 (E.D. Pa. Mar. 27, 1995).

There is contradictory evidence as to whether Deli or First National was responsible for the pertinent misrepresentations. The question of who was responsible for the misrepresentations and the intent with which they were made should be resolved at trial when witnesses with pertinent knowledge can be subject to cross-examination and their credibility weighed by the trier of fact.

Accordingly, the entry of summary judgment against either defendant is not appropriate.

4. Deli's Statutory Bad Faith Counterclaim

For purposes of 42 Pa. C.S.A. § 8371, "bad faith" includes "any frivolous or unfounded refusal to pay proceeds of a policy." Terletsky v. Prudential Property & Casualty Ins. Co., 649 A.2d 680, 688 (Pa. Super. 1994), appeal denied, 659 A.2d 560 (Pa. 1995). To prevail on a § 8371 claim, the insured "must show that the defendant did not have a reasonable basis for denying benefits under the policy and that the defendant knew or recklessly disregarded its lack of reasonable basis in denying the claim." Younis Bros. & Co. v. CIGNA Worldwide Ins. Co., 899 F. Supp. 1385, 1396 (E.D. Pa. 1995)(quoting Terletsky, 649 A.2d

at 688), aff'd, 91 F.3d 13 (3d Cir. 1996), cert. denied, 117 S. Ct. 737 (1997). A plaintiff must establish bad faith by clear and convincing evidence. See Terletsky, 649 A.2d at 688.

When the insured makes a material misrepresentation in the insurance application, the insurer does not act in bad faith by denying the claim in the absence of evidence of some dishonest purpose. See Jung, 949 F. Supp. at 360-61. The question is not whether an insurer's legal analysis turns out to be wrong, but what it reasonably believed at the time. Id. at 358-59.

There is no competent evidence of record to controvert plaintiff's position that it denied coverage based on a reasonable conclusion at the time that the insured had knowingly supplied false material information when it sought coverage.[3] On the record presented, one could not reasonably find by clear and convincing evidence that plaintiff acted in bad faith when it denied coverage. Accordingly, summary judgment will be granted for plaintiff on Deli's bad faith counterclaim.

5. Deli's Common-law Fraud Counterclaim

To sustain a common-law fraud claim, a claimant must prove:

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[3] That the misrepresentations may have been made by First National while conceivably acting as an agent for Specialty may have contractual consequences but would not alter the fact that plaintiff is not liable for bad faith conduct under § 8371 if it reasonably concluded at the time that Deli was responsible for the misrepresentations on which denial of coverage was based.

> a fraudulent utterance of a misrepresentation;
>
> which the applicant knew was false or otherwise made in bad faith;
>
> intent by the maker that the recipient be induced to rely on the misrepresentation;
>
> justifiable reliance by the recipient; and
>
> damage to the recipient.

Tudor Ins. Co. v. Township of Stowe, 697 A.2d 1010, 1015-16 (Pa. Super. 1997). Common-law fraud also must be proven by clear and convincing evidence. See Moser v. DeSetta, 589 A.2d 679, 682 (Pa. 1991); Sewak v. Lockhart, 699 A.2d 755, 759 (Pa. Super. 1997).

In this counterclaim Deli alleges that plaintiff knew and chose to ignore the misrepresentations on which its denial of coverage was based and that Deli justifiably relied on plaintiff's extension of coverage. A nonmovant may not rest upon mere allegations in his pleadings. Plaintiff has not presented any competent evidence to show that plaintiff or Specialty knew about the seven or more undisclosed prior claims or to controvert their averments that the policy would not have been issued if they had known. Plaintiff has not produced evidence from which one could reasonably find by clear and convincing evidence that plaintiff committed fraud. Accordingly, summary judgment for plaintiff will be granted on Deli's fraud counterclaim.

B. Specialty's Motion for Summary Judgment

Specialty asserts that the insurance policy is void due to the misrepresentations in the application and if it is not that under their brokerage agreement, First National is obligated to indemnify Specialty for "any liability found against Specialty for issuing the policy to Deli."

Because Mr. Rosenwald's deposition testimony could be credited and it may be found that First National was acting for Specialty, summary judgment for Specialty on the ground that the policy is void as a matter of law is not appropriate.

First National argues that Specialty's motion regarding the indemnification claim is premature since its liability has not yet been determined, and that the transmission to Specialty of an insurance application containing information which First National thought was accurate does not require indemnification under the brokerage agreement.

Specialty's motion is not premature. Specialty asserted a cross-claim against First National for contractual indemnity. A defendant may file a cross-claim against any co-defendant who "is or may be liable to the cross-claimant for all or part of a claim asserted in the action against the cross-claimant." See Fed. R. Civ. P. 13(g) (emphasis added). Thus, "a cross-claim need not be mature at the time the cross-claim is originally asserted." Glaziers and Glassworkers

Union Local 252 Annuity Fund v. Newbridge Securities, Inc., 823 F. Supp. 1188, 1190 (E.D. Pa. 1993); 6 Charles A. Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure § 1431, at 240 (2d ed. 1990 & Supp. 1998).

In construing substantially identical language governing third-party complaints, courts have recognized that Rule 14(a) "permits a defendant to bring in a third-party defendant even though the defendant's claim is purely inchoate -- i.e., has not yet accrued under the governing substantive law -- so long as the third-party defendant may become liable for all or part of the plaintiff's judgment." Andrulonis v. United States, 26 F.3d 1224, 1233 (2d Cir. 1994). See also IHP Industrial, Inc. v. Permalert, ESP, 178 F.R.D. 483, 487 (S.D. Miss. 1997) ("Rule 14 does not require that the third-party plaintiff await the outcome of the plaintiff's claim against it before it may assert its third-party claim" even when the defendant's cause of action for indemnity has not yet arisen under state law); Tormo v. Yormark, 398 F. Supp. 1159, 1175 n.20 (D.N.J. 1975) (same).

There is a factual dispute as to who was responsible for the misrepresentations on Deli's insurance policy. The indemnity agreement on its face does not require First National to indemnify Specialty if First National did not and had no reason to know that the pertinent information in the Deli application was false. Should Mr. Rosenwald's testimony that a

First National representative was responsible for these misrepresentations be believed, First National would be obligated to Specialty. Thus, summary judgment on this claim is not appropriate.

V. Conclusion

Consistent with the foregoing, plaintiff's motion for partial summary judgment will be granted as to Deli's counterclaims for fraud and bad faith under § 8371, and plaintiff's motion will otherwise be denied. Specialty's motion for summary judgment will be denied. An appropriate order will be entered.

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O R D E R

AND NOW, this day of March, 1999, upon consideration of plaintiff's Motion for Partial Summary Judgment (Doc. # 34) and defendant Specialty Insurance Agency, Inc.'s cross-Motion for Summary Judgment (Doc. #42), and the responses thereto, consistent with the accompanying memorandum, **IT IS HEREBY ORDERED** that plaintiff's Motion is **GRANTED** as to Deli by Foodarama's counterclaims for fraud and insurance bad-faith, and is otherwise **DENIED;** and, defendant Specialty Insurance Agency's Motion is **DENIED**.

BY THE COURT:

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JAY C. WALDMAN, J.